No. 10204

In the United States Circuit Court of Appeals for the Ninth Circuit

CLAUDE R. FOOSHE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
WILLARD H. PEDRICK,
Special Assistants to the Attorney General.

INDEX

CITATIONS

490831—42——1

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 10204

Claude R. Fooshe, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is that of the Board of Tax Appeals (R. 54–69) reported in 46 B. T. A. 205.

JURISDICTION

This petition for review (R. 70–74) involved federal income tax for the taxable year 1938. On February 8, 1941, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in the total amount of $1,436.37. (R. ~~7~~ 54.) Within 90 days thereafter and on March 11, 1941, the taxpayer filed a petition with the Board of Tax Appeals for a redetermination of that deficiency under Section 272 of the Internal Revenue Code. (R. 3–12.) The decision of the Board sustaining the deficiency was entered January 28, 1942. (R. 70.) The case was brought to this Court for review by petition filed April 23, 1942 (R. 70–74), pursuant to the provisions of Sections 1141–1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether renewal commissions on insurance policies sold in Missouri through the taxpayer's agency while he was there domiciled and received by him in California while domiciled there are his separate property taxable to him in full under Section 22 (a) of the Revenue Act of 1938.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> Sec. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

Civil Code of California (1937):

> Sec. 161a. *Interests in community property.* The respective interests of the husband and wife in community property during continuance of the marriage relation are present, exist-

ing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property.

Sec. 164. *Property acquired after marriage: Presumptions: Limitation of actions.* All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domiciled in this State, is community property; * * *.

STATEMENT

The facts as stipulated by the parties and found by the Board may be briefly summarized as follows:

In 1919 the taxpayer entered the employ of the Prudential Insurance Company (referred to herein as the company) as manager of an ordinary agency in St. Louis, Missouri. Under the contract then drawn up (referred to herein as the old contract) the taxpayer was entitled, among other things, to a commission on all renewal premiums on policies written through his agency in an amount that for purposes of this proceeding is stipulated as two and one-half per cent. (R. 55, 59–60.)

These renewal commissions were to continue for a specified period of years after sale of the policies subject to reduction to one-half of one per cent if the taxpayer left the managership. (R. 61.) The contract was amended in 1927 so as to largely eliminate this reduction on termination of the agency in the event of the agent's death, retirement, disability or the withdrawal of the company from the territory. If the agency was terminated for other causes, the reduction of the commission to one-half of one per cent was provided. In addition, if the contract was terminated because of a breach of trust by the agent, the entire commission was forfeited. (R. 40.)

Prior to May, 1938, the taxpayer was approached by the company on the subject of exchanging the St. Louis managership for one in Los Angeles, California. The taxpayer was agreeable save for the matter of financial arrangements. The nature of compenation provisions of the standard managerial contracts written by the company in 1938 differed from the old contract secured by the taxpayer in 1919 as amended in 1927. That fact and the smaller volume of policy sales in the Los Angeles agency meant a loss of income if St. Louis renewal commissions of two per cent were lost by the move. (R. 55–59.) In order to make it financially feasible for the taxpayer to accept the Los Angeles agency under the new type contract the company informally agreed to waive any right to a forfeiture of the two per cent. This agreement was expressed in a letter written by the taxpayer from St. Louis and confirmed in a letter from the company's New Jersey office addressed to him there. (R. 56.) Thereafter he entered into the standard new type contract to manage the Los Angeles agency and the old contract was formally cancelled. (R. 64–65.)

Between the time of his arrival in Los Angeles on or about May 1, 1938, when he established his domicile in California and the end of that year he received Missouri renewal commissions in the sum of $21,504.80. (R. 57.) He and his wife divided this income on their tax returns as community property. (R. 60.) Thereafter the Commissioner assessed a deficiency against the taxpayer in the amount of $1,436.37 principally on the ground that the entire $21,50~~8~~4.40 was the husband's separate property and taxable in full to him. (R. 54.) It is conceded that the one-half per cent commission payable under the old contract without regard to termination of the agency is the taxpayer's separate property. (R. 59.) The taxpayer contends however that the commissions from the two per cent (referred to herein as the renewal commissions) are community property. His appeal to the Board of Tax Appeals resulted in affirmance of the Commissioner's determination. (R. 70.) From that decision this appeal has been prosecuted.

SUMMARY OF ARGUMENT

The decision of the Board of Tax Appeals that the renewal commissions received by the taxpayer in California are his separate property is based on sound principles. If the test of the character of community property were, as contended by the taxpayer, domicile at the time the service was rendered, the renewal commissions here involved are his separate property. The services for which these commissions were paid the taxpayer in California were rendered in Missouri by the sale of the original policies through the St. Louis agency managed by the taxpayer while there domiciled.

The issue as to where the service was rendered is in any event a factual question. Even if there is some basis for the taxpayer's version of the facts, the Board of Tax Appeals' determination on the evidence before it that the commissions were paid for services rendered in Missouri cannot be disturbed on appeal.

As a matter of fact the Board's decision that the renewal commissions are the taxpayer's separate property would have to be sustained even if part of the service for which they were paid was rendered in California. The right under the decisions of the Supreme Court to split community property between the spouses for federal tax purposes extends only to income classified as community property by the local law. Under the California law personal property acquired by the husband in a non-community property state while there domiciled remains his separate property on his removal to California. This is true even if the property is received by him in California for the first time. The test is not the place of receipt but domicile at the time of acquisition. Acquisition in turn does not mean securing an immediate right to the personal property. For community property purposes the making of a contract by the husband is an acquisition of a property interest so that personal property thereby received is deemed to have been acquired as of the contract date. Hence, such property is classified by reference to the law of the husband's domicile at the time the contract was entered into. Thus a contract secured by the husband in Missouri while domiciled there entitling him to renewal commissions on insurance policies sold through his Missouri agency was separate personal property acquired by him there. Receipt of the fruits thereof in California did not convert this separate property. It was therefore taxable to the husband in full.

ARGUMENT

I

Under the "Domicile at Time of Service" Test of Community Property Asserted by the Taxpayer the Renewal Commissions Are His Separate Property

Following the taxpayer's move to California in 1938 he there received during the balance of the tax year some $21,504.80 as renewal commissions on insurance policies previously sold through his St. Louis, Missouri, agency and payable by virtue of a contract made by him while still domiciled in that state. The decision of the Board of Tax Appeals that these Missouri-based commissions are the separate property of the taxpayer and taxable to him in full is attacked on the theory that these commissions in some fashion represent pay for service rendered in California after he established his domicile there in May, 1938. From this the taxpayer would conclude that the commissions are community property under the California law. Whether that would follow if the commissions were based in part on California service is considered in the second portion of this brief. Even if this "law" propounded by the taxpayer be accepted, however, these commissions are his separate property for they were paid for service previously rendered in Missouri.

The outstanding characteristic of these renewal commissions received by the taxpayer after establishing his California domicile is the fact that they are based on and measured entirely by policies sold through the taxpayer's agency while he was domiciled in Missouri. There is nothing in the record that indicates any relation between particular California service rendered by the taxpayer in the tax year of 1938 and payment of these commissions. Nor is there any evidence that the company regarded them as compensation for any particular service there rendered. As a matter of fact the only management contract for the Los Angeles agency agreeable to the company was the standard new-type contract covering compensation for all service of agency management and that standardized contract was the one signed by the taxpayer. The compensation provided by that contract represented all the company would pay for the service rendered in California. The taxpayer's right to the renewal commissions on transfer to Los Angeles was the result of the company's previous waiver of any right to a deduction from compensation for service previously rendered in Missouri by the taxpayer while there domiciled. Thus under the "domicile at the time of service" test of community property asserted by the taxpayer the renewal commissions must be regarded as his separate property and taxable as such.

The taxpayer's argument to the contrary is based on aspects of the various contracts that are either of no significance or positively support the Commissioner's position. In brief, the taxpayer argues that under the old contract the renewal commissions were in reality paid for collection of the premiums and that on leaving the St. Louis agency his right to the commissions was lost, so their continued payment, after he assumed management of the Los Angeles agency and ceased to perform the collection service for the Missouri policies, represented additional pay for management of that California agency. A number of factors require rejection of this version of the facts.

At the outset it may be observed that, while the burden of proof is on the taxpayer, he adduced no evidence to show that this collection service on the Missouri policies was of such character as could reasonably represent the true consideration for the renewal commissions. The fact that the taxpayer received no commission for collection under his California contract (Pet. Br. 5) raises the question whether that could reasonably be the case. In this connection it is significant that insurance agency contracts often make renewal commissions payable without regard to further service by the agent after the original sale. See *Helvering* v. *Eubank,* 311 U. S. 122, where such contracts were involved. Under such a contract the renewal commission is paid for the service in making the original sale and the fact that the commissions are conditioned on the payment of the renewal premiums by the policyholder does not obscure that fact. Presence in an agency contract of a provision forfeiting the commission on loss of the agency (thus providing an additional incentive for remaining with the company) does not establish that the commission is paid for collection of the renewal premiums. It establishes only that there may be a forfeiture of the earned commission in the named contingency. That this represents the view of insurance men is indicated by the following statement from an article by James R. Love in the National Underwriter for April 9, 1937 (p. 2):

> When an agent places business on the books of a company he receives a vested interest in the form of renewals. When he resigns to represent another company or fails and turns to other business these renewals are often forfeited or subject to a deduction. The policyholder who continues to pay full premiums is "orphaned". * * *

In accord with this practical construction of these agency contracts is the statement in a letter to the taxpayer from his superior relative to the waiver agreement. In this letter it was stated that on transfer to Los Angeles the taxpayer would continue to receive the full renewal commission, that "in other words, no collection fee will be imposed on the business *for which you have qualified for renewal commissions.*" (R. 64.)

It is significant that neither the old contract nor its amendment refers to any portion of the commission on renewals as a "collection fee". That term is reserved for designation of pay for service in collection of premiums on which the agent is *not entitled to his renewal commissions or deduction by the company from the agent's renewal commission on termination of the agency.* (R. 61–62.) Moreover, the old contract itself in Section 21 (Pet. Br. 35 ~~5~~) describes the loss of renewal commission on termination of the agency as a "forfeiture." Of surpassing significance also is the 1927 amendment of the contract providing in effect that the agent should receive the full two and one-half per cent renewal commission if the agency was terminated by his retirement at 65, his death, disability, or the withdrawal of the company from the territory. In these contingencies the renewal commissions were to be paid *even though no collection service was given.*

The foregoing considerations are persuasive, in the conspicuous absence of proof by the taxpayer concerning the nature of the collection service, that such service was not the real consideration for the renewal commissions and that a provision for a deduction from the commission on termination of the agency was, however styled, a forfeiture of compensation already earned. Thus it is of no moment that the company could have imposed a forfeiture on transfer of the agent, if such was the case. Waiver of that forfeiture simply assured the taxpayer of his right to compensation for *service previously rendered by him in Missouri while there domiciled.*

The same conclusion is reached if the matter is approached with reference to the waiver agreement that preceded the taxpayer's transfer to Los Angeles. In connection with this agreement by the company to forego any deduction from the Missouri renewals on the transfer, the question may be asked whether, in the event of a wrongful discharge from the Los Angeles agency, the taxpayer would be entitled to the full renewal commissions as compensation for service previously rendered. That in turn depends on whether the commissions were payable for past service or future service.

Considerations detailed in the preceding paragraphs all support the view that the commissions were payable for past services, subject to a possible forfeiture on transfer of the agent. At this point it may be observed that the old contract, as amended in 1927, stipulated against a forfeiture on certain contingencies terminating the agency through no fault of the agent, *viz.,* his retirement, death, disability or the withdrawal of the company from the territory. For practical purposes a transfer of the agent amounts to a "withdrawal of the company from the territory". A common sense interpretation of this old contract as amended would lead one to question the power of the company, on its own motion, to defeat the agent's right to renewal commissions by a transfer to another agency. Since the parties' relation was amicable that issue never ripened into a law suit. Their practical construction of the old contract approved treating a transfer similar to other agency-terminating contingencies not the agent's fault and made the renewal commissions on policies previously sold payable nothwithstanding the transfer.

It is noteworthy that none of the parties' correspondence expressing the waiver agreement (R. 64, 65) refers to any future service to be performed as the exchange for payment of the renewal commissions—on the contrary this correspondence stated that the commissions would be paid "same as had I (taxpayer) remained here (Missouri) only the Co. will bear expense for collecting to the 10th yr." and "no collection fee will be imposed on the business for which you (taxpayer) have qualified for renewal commissions". (R. 64.) It seems clear that the waiver agreement entered into by the parties prior to the taxpayer's move to California was a promise to pay for past service subject only to a possible implied condition that he continue in the company's employ. This construction is further reinforced by the fact that the amount of the payments was to be measured by Missouri service, not California service. Finally, the compensation for service to be rendered in managing the Los Angeles agency was comprehensively covered by the standard new-type agency contract and that was the only contract the company was willing to make with respect to that service, a circumstance persuasive that the renewal commissions were paid for previous service in St. Louis. The management of that agency was at most only a condition, not the consideration for the renewal commissions. The *quid pro quo* for these payments was the past service rendered in Missouri.

Since the *waiver agreement* made the renewal commissions on policies previously sold payable after the transfer subject only to a possible implied condition that the taxpayer remain in the company's employ, it is clear that the company could not escape liability for these commissions by wrongfully discharging him. The *waiver agreement* gave the company no such power and none can be implied. Hence cases involving contractual provisions giving the company complete power to divest the agent of his right to renewals are irrelevant.[1] The significant contract, the waiver agreement,

[1] It is noteworthy that all cases cited in the taxpayer's brief (p. 12) as denying an agent's right to renewal commissions after termination of the agency are cases involving either an abandonment of the agency by the agent, wrongful conduct on his part justifying his discharge, or a contractual provision authorizing a forfeiture.

contained no such provision. When the contract simply provides for payment of renewal commissions without provision for forfeiture the company cannot escape liability therefor by wrongfully discharging the agent. Thus in *Lewis* v. *Atlas Mutual Life Ins. Co.*, 61 Mo. 534, it was held that the insurance company could not defeat the agent's right to renewal commissions by going out of business. In *Merchants Life Ins. Co.* v. *Griswold*, 212 S. W. 807, 813 (Tex. Civ. App.), elimination by the company of one type of policy was held ineffective to defeat the agent's right against it for renewal commissions thereon. For similar cases see 79 A. L. R. 887. Cf. *Kelly-Springfield Tire Co.* v. *Bobo*, 4 F. 2d 71 (C. C. A. 9th). These cases are in harmony with the general principle that an employer's liability under a promise of pay for service till the end of a period cannot be defeated with respect to services rendered by a wrongful discharge before the end of the period. *Roberts* v. *Mills*, 184 N. C. 406, 114 S. E. 530; *Zwolanek* v. *Baker Mfg. Co.*, 150 Wis. 517, 137 N. W. 769. For further citations see the annotation in 28 A. L. R. 346. See also Williston on Contracts (Rev. Ed., 1936), Vol. 3, Sec. 677.

In the event of the taxpayer's wrongful discharge from the Los Angeles agency it seems clear from the foregoing that he would certainly be entitled to full payment of the renewal commissions. If it be recognized that on a wrongful discharge the taxpayer would be entitled to full payment of the renewal commissions under the waiver agreement on the ground that such commissions represent pay for service previously rendered, so also in this proceeding must it be concluded that the renewal commissions received by the taxpayer in California constituted payment for service rendered in Missouri while he was there domiciled. It is clear, of course, that such income is the taxpayer's separate property and taxable as such even though it was received in California. *Wrightsman* v. *Commissioner,* 111 F. 2d 227 (C. C. A. 5th); *Asher* v. *Welsh* (S. D. Cal.), decided May 24, 1938 (24 A. F. T. R. 1091, 1097); *Honnold* v. *Commissioner,* 36 B. T. A. 1190, 1195.

The fact repeatedly emphasized in the taxpayer's brief that it was payment of these commissions that made it financially feasible for the taxpayer to accept the Los Angeles agency and that this was the reason that prompted the company to enter into the waiver agreement is in nowise inconsistent with the conclusion that these renewal commissions were paid for past services. If the taxpayer was not entitled as a matter of right under the old contract to these commissions on his transfer then the waiver agreement was simply in the nature of a contract to pay a bonus for past service and the company's motivation in determining to make such payments does not change the character of the service upon which the payments were based.

Finally, it must be pointed out that the question where the taxpayer performed the service for which these commissions were paid is essentially one of fact. Were they paid for Missouri service or California service? The burden was on the taxpayer to prove the latter—in fact the evidence before the Board of Tax Appeals indicated that the commissions were paid for Missouri service. The Board stated that "we come to the conclusion that the petitioner has not shown the income to be earnings of petitioner while a member of a marital community in California" and at a later point again stated that "in our opinion, this proceeding involves, not additional compensation earned in California, but performance of a condition involved in the contract wherein the amounts involved have their inception." (R. 66, 69.) This factual determination by the Board cannot, on the evidence in the record, be disturbed on appeal for the Board's findings of fact on conflicting evidence are conclusive. *Helvering* v. *Lazarus & Co.*, 308 U. S. 252; *Wilmington Trust Co.* v. *Helvering,* 316 U. S. 164; *Helvering* v. *National Grocery Co.,* 304 U. S. 282. As stated in this last case (p. 294), "To draw inferences, to weigh the evidence and to declare the result was the function of the Board."

In this appeal the fact that the commissions in question were paid for service in Missouri while the taxpayer was there domiciled must be taken as the fact and the decision of the Board accordingly affirmed.

II

Under the Fundamental "Domicile at the Inception of the Right" Test of Community Property the Missouri Renewal Commissions Are the Taxpayer's Separate Property

The consideration of the taxpayer's contention in the foregoing section is actually predicated on a legal propoposition more favorable to him than that to which he is entitled. It is clear under the Supreme Court's decisions in *Poe* v. *Seaborn,* 282 U. S. 101, and *United States* v. *Malcolm,* 282 U. S. 792, according the privilege of splitting community income between the spouses for federal tax purposes, that this privilege extends only to income classified as community property under the local law. This truism is accepted by the taxpayer (Br. 19) and the entire legal basis for his attack on the decision of the Board of Tax Appeals denying the right to report half of these commissions as his wife's income is the asserted proposition that "the character of income as community or separate under the [conflict of] laws of California is to be determined in accordance with the [property] laws of the husband's domicile at the time the income is earned * * *". (Br. 19.) None of the decisions cited under this asserted principle, however, presented the issue as to whether it is the property law of the state of domicile *at the time of service or at the time the right to the property was acquired* that governs. The taxpayer's reliance on the proposition quoted does raise that issue here, and in resolving it consideration must be given other authorities than those cited.

In Section 164 of the California Civil Code the Legislature of California undertook by statute to adopt a conflict of laws rule respecting classification of property that, if valid, would have required the conclusion that these Missouri commissions are community property. Under Section 164 the test prescribed was whether the property would have been community property if acquired by the spouse while domiciled in California. Since California follows the generally accepted view that the law of the domicile regulates the spouse's interest in acquisitions of personal property (see California cases cited in the paragraph following) all personal property, under this statutory mandate, would become community property on establishment by the spouses of a California domicile. In the case of *Estate of Thornton,* 1 Cal. 2d 1, 33 P. 2d 1, the California Supreme Court held this portion of Section 164 unconstitutional on the ground that it attempted destruction of a vested right to personalty previously acquired as separate property by one of the spouses in a non-community property state, thus violating the due process clauses of both federal and state constitutions.

In the light of this decision the character of the taxpayer's commissions as community or separate property under California conflict of laws must be determined not by reference to the Code but by consideration of the California decisions on the subject. Under these decisions it is settled that personal property acquired by the husband in a non-community property state while there domiciled remains his separate property when removed to California on his establishing a domicile there. *Shea* v. *Commissioner,* 81 F. 2d 937 (C. C. A. 9th); *Estate of Thornton, supra; Estate of Arms,* 186 Cal. 554, 199 Pac. 1053; *Kraemer* v. *Kraemer,* 52 Cal. 302; *Estate of Frary,* 26 Cal. App. 2d 83, 78 P. 2d 760. For further citations see Leflar, Community Property and The Conflict of Laws, 21 Cal. L. Rev. 221, 226 (1932). Thus, if the separate property was acquired by the husband while domiciled in a non-community property state even though not received by him until domiciled in California it will retain its character as a separate property. *Wrightsman* v. *Commissioner,* 111 F. 2d 227 (C. C. A. 5th); *Asher* v. *Welsh* (S. D. Cal.), decided May 24, 1938 (24 A. F. T. R. 1091, 1097). *Honnold* v. *Commissioner,* 36 B. T. A. 1190, 1195. See also *Preston* v. *Commissioner,* 35 B. T. A. 312, 322; *Houston* v. *Commissioner,* 31 B. T. A. 188. Furthermore the income from personal property acquired by the husband while domiciled in a non-community property state is his separate property though produced by it in California after his domicile is there established. *Shea* v. *Commissioner, supra.* The suggestion made in some of the early conflict of laws treatises that the law of the intended domicile governed with respect to acquisitions made in anticipation of a move to another jurisdiction has no support in the cases. Judge Goodrich, in his Conflict of Laws (1939), Section 120, reviews the authorities and finds that under the cases and on principle it is the law of the domicile at the time of acquisition, not the law of the intended domicile, that governs. This exhaustive treatment first appeared as an article in 27 Yale Law Journal 49. In accord with this view is the Restatement of the Conflict of Laws, Sec. 289.

Thus, under the California decisions above referred to, the test of the character of personal property is domicile at the time of its acquisition. That is the view held almost without exception in all of the community property jurisdictions. See the authorities collected by Leflar, *supra;* 92 A. L. R. 1347, 1348; and in Community Property, 11 Am. Jur. 184, Section 15. The question is, what constitutes acquisition? That issue is presented when the husband enters into a contract entitling him to property in exchange for services to be rendered in the future. Is the property acquired for community property classification purposes when the contract is made or when the services are rendered? The answer is had by reference to the doctrine of "inchoate rights" which the taxpayer concedes to be well established in California. (Br. 20.) Under this doctrine, as is stated in the McKay's authoritative treatise on Community Property (2d Ed.), Sec. 517:

> * * * if the initial right rests in obligation, all that which is obtained through the performance, discharge, satisfaction, enforcement or assignment of the obligation, are deemed in law to have been acquired as of the date of the acquisition of the initial right, and take the character, as separate or common, of that right.
>
> The performance of conditions, or the payment of charges against a thing or its increase or improvement, does not convert it from separate into common property or *vice versa*, though it may in some cases create a charge against it. In brief a thing is deemed to be acquired as of the time of the acquisition of the initial right of which it is the development.

The taxpayer's reference to a later statement in this section to the effect that the doctrine of inchoate rights operates only with respect to rights valid in law or equity is no more than a straightforward statement that the contract must be binding. The matter is made clear beyond question in Section 535 of the same treatise where it is stated:

> If the contract is largely executory and the conditions and stipulations of the contract are burdensome, and are performed by the community, it may seem to some like a legal nicety devoid of substantial justice to refer the origin of the

property to the date of closing the contract through which it was acquired; but generally justice is better subserved by the rule *now firmly established that property acquired by contract is deemed to have its origin as of the date of the contracts.* [Italics supplied.]

And it is not difficult to find a justification for the rule: The contract itself is property, and having been acquired before marriage it is separate by force of the plain terms of the statute. If it should be sold without performance of the conditions clearly the proceeds of the sale would be separate, and if the conditions are performed after marriage through the expenditure of separate funds no one would insist that the property is common. The community may be reimbursed for its funds used to perform the conditions and when this is done even and exact justice is done to all; the separate estate obtains the advantages of its separate contract, or suffers the disadvantages of any, and the community is reimbursed for its outlay. If the circumstances impose no obligation to make reimbursement, this should not change the rule just stated.

This Court recognized and approved these principles in *Davidson* v. *Woodward,* 156 Fed. 915, certiorari denied, 209 U. S. 547, where it is stated that "Property purchased by a contract before marriage but not paid for until after marriage, is also separate property".

One of the leading cases on the subject is *Welder* v. *Lambert,* 91 Texas 510, 44 S. W. 281. There the husband entered into a contract in 1928 to introduce into the State of Coahuila and Texas a certain number of settlers. In return for this service he was to receive unspecified land to be selected by him on his performance of the agreement. He married in 1832. Some of the services called for by the contract was rendered before marriage and some afterwards. It was held that the property secured by this contract was entirely the separate property of the husband on the ground that, since the contract right was separate when secured, its fruits were likewise. In other words, the acquisition date is the contract date. That the question in the case was whether the property had been acquired before marriage rather than before change of domicile as here is not significant. The decision squarely holds that for community property classification purposes the date of acquisition is the date the binding executory contract for the property is made.

It may be noted in passing that the doctrine of inchoate rights is not one of "equitable conversion" limited in application to contracts for the purchase of real estate.[2] See McKay, Section 534, fn. 8. On its facts *Welder* v. *Lambert, supra,* simply involved an executory contract of service with unspecified land as the compensation. As observed in *Commissioner* v. *King,* 69 F. 2d 641 (C. C. A. 5th), in discussing the case:

> The facts of that case (*Welder* v. *Lambert*) negative the conclusion that the land was held to be the separate property of the husband because of his having had an inchoate title to that land prior to the marriage, as at the time of the marriage he had no claim to any specific or then

[2] Statement in some of the California decisions that the doctrine of "inchoate rights" rests on equitable title is only dictum. Refusal to apply the doctrine has been limited to the situation where no binding contract (i. e., no right) existed at the earlier date. Cf. *In re Boody*, 113 Cal. 682, 45 Pac. 858.

> identifiable land. The statements in the opinion in that case of the grounds upon which the conclusion reached was based indicate that the test therein stated for determining whether property is separate or common is applicable whether the property is real estate or personalty, land *or a sum of money.* (Italics supplied.)

The decision of *Commissioner* v. *King, supra,* is particularly instructive in the instant case. There the husband during marriage entered into a contract for the rendition of legal services on a contingent fee basis. Part of the services were rendered before and a part after the wife's death. The court followed *Welder* v. *Lambert, supra,* discussed above, and held that the property in the contingent fee had been acquired by the community on the formation of the contract so that the fee on its receipt was entirely community property and taxable on that basis.

Since, as seen above, the doctrine referring the acquisition date to the contract date is that of inchoate right rather than equitable conversion, California cases applying the doctrine to land contracts are equally authoritative with respect to contract secured property in general. Under these decisions it is settled that when a binding contract for property is entered into by the husband at a time when such property would be his separate property, the property secured thereafter is separate even though received when he is subject to the community property system and even though the community in fact contributed to the purchase of the property. *Estate of Pepper*, 158 Cal. 619, 112 Pac. 62; *In re Lamb,* 95 Cal. 397, 30 Pac. 568; *Harris* v. *Harris,* 71

Cal. 314, 12 Pac. 274. See also *Lake* v. *Lake*, 52 Cal. 428. The fact that the community in a probate proceeding may be entitled to reimbursement for its contribution to the performance of the contract does not alter the fact that property received by reason thereof is separate on its receipt by the husband in the first instance if the contract was entered into by the husband before he was subject to the community property system.[3] *Morgan* v. *Lones,* 80 Cal. 317, 22 Pac. 253; *Palen* v. *Palen,* 28 Cal. App. 2d 602, 83 P. 2d 36.

The California decisions thus accord with the general law of community property in that property is deemed to be acquired for classification purposes when the bind-

---

[3] Under the Louisiana decisions proceeds of an insurance policy taken out by the husband before coverture are his separate property even though most of the premiums thereon were paid after marriage by community funds. Those decisions were reviewed with approval in the case of *Estate of Castagnola*, 68 Cal. App. 732, 230 Pac. 188. Consistent with this is the decision of the California Supreme Court in *Travelers' Ins. Co.* v. *Fancher*, 219 Cal. 351, 26 P. 2d 482, stating that the proceeds are community property "where premiums of an insurance policy issued on the life of a husband *after coverture* are paid entirely from community funds * * *." [Italics supplied.]

In *Modern Woodmen of America* v. *Gray*, 113 Cal. App. 729, 299 Pac. 754, the view was taken that payment of the premiums with community funds entitles the community to a proportionate portion of the proceeds. If this intermediate appellate decision represents the law of California it may be reconciled with the established doctrine of "inchoate rights" by virtue of the peculiar nature of insurance contracts—each year's premium payment is a renewal of the contract. Even if this peculiar feature of insurance contracts be disregarded, the community's share in the proceeds may be treated as merely a method of reimbursement. Since the contract involved in the instant case is not an insurace policy, any peculiar doctrine with respect to such cases is not here relevant.

ing contract for it is made. With this proposition clearly established, accurate statement of the California conflict of laws principle applicable to the instant case is simple. It will be recalled that California follows the accepted view that property acquired by the husband in a non-community property state while there domiciled is his separate property even though removed by him to California after he is there domiciled. Since acquisition means the inception of the right, or to put it otherwise, the formation of the binding contract for the property, it is seen that the test of property acquired by the husband is domicile at the time of the formation of the contract, not as stated by taxpayer's counsel, domicile at the time of its performance. The parade of horribles considered by the taxpayer as naturally following from such a rule of law (Br. 22) is easily seen as illusory if regard is had for the fact that the test has reference to domicile at the time of contracting—not mere physical presence in the state.

Whether the non-community property law of domicile at the time of contracting would govern if the entire performance took place in a community property state after the spouses settled there need not be decided here. Certain it is under the authorities above reviewed that the law of domicile at the time of contracting does control where a part of the performance takes place in that jurisdiction. It appears from the record that the taxpayer managed an insurance agency in St. Louis for a number of years prior to May, 1938, under a contract entitling him to a two and one-half per cent renewal commission on policies sold through his agency.

It was provided by the contract, as amended in 1927, that if the contract was terminated, save by death, retirement, disability or withdrawal of the company from the territory, that a two per cent commission fee would be deducted from these renewal premiums leaving him only one-half of one per cent as commission. In order to induce him to assume management of their Los Angeles agency the insurance company by a contract made while the taxpayer was domiciled in Missouri and confirmed under a letter to him there from the company's New Jersey office (R. 44) bound itself to pay the full two and one-half per cent commission for the periods specified in the original agency contract on his transfer, thus treating this contingency of transfer as comparable to those enumerated in the 1927 amendment contract not justifying a forfeiture. It cannot be denied that the original source of these renewal commissions was the old agency contract made in Missouri and the sale of policies through the taxpayer's agency in St. Louis while he was there domiciled. Nor can it be denied that the contract recognizing his right to continued payment of the St. Louis commissions on his transfer to Los Angeles *was made while he was still domiciled in Missouri.* Thus we have a case where the contract for payments received by the taxpayer was not only acquired, while he was domiciled in Missouri, as separate property but as well these payments were to be made on the basis of a previous expenditure of the taxpayer's separate property—his service in Missouri while there domiciled. Under the established doctrine of "inchoate rights" the renewal commissions must therefore be deemed to have been acquired by the taxpayer in

Missouri while there domiciled and hence classified as his separate property on their receipt in California.

If there was any basis for a claim for reimbursement by the community for services rendered by the husband in California in connection with these renewal commissions that claim is not here in issue.[4] Failure by the taxpayer to establish the amount to which the community is entitled to reimbursement (*Shea* v. *Commissioner, supra*) and the further damning fact that no such claim has been asserted against him require the conclusion that the receipt is taxable to him in full—his income is reported on a cash basis. In *Commissioner* v. *King, supra,* part of the service had been rendered subsequent to the termination of the community by the wife's death. It was argued that the income thereby produced constituted the taxpayer's separate property since his personal estate was entitled to reimbursement from the community in that amount. In answer to this argument the court observed that no such claim for reimbursement had been made and concluded (p. 642): "This being so the question of whether such a claim would have been allowable if it had been made is not presented for decision." The entire fruits of the contract were there taxed on the basis of the existence of the community on the date the contract was made.

It must be concluded that whether the test of community property is domicile at the time of service or

[4] That such service could not constitute the entire price for the commissions is indicated by the authority cited by the taxpayer's brief, p. 13, to the effect that "the right to commissions on renewals rests, *in part*, on the consideration of the services by the agent to the company in keeping the policies written by him alive". [Italics supplied.]

domicile at the inception of the right these Missouri renewal commissions are the taxpayer's separate property. Any alleged right of reimbursement in the community is neither in issue here nor is there any foundation for such a claim in fact. These commissions were paid for previous service by the taxpayer in Missouri while there domiciled under a contract made while he was still there.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should therefore be affirmed.

Respectfully submitted.

Samuel O. Clark, Jr.,
Assistant Attorney General.

Sewall Key,
Willard H. Pedrick,
Special Assistants to the Attorney General.

October 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942